

<b>ISLE OF ANGLESEY COUNTY COUNCIL</b>	
<b>REPORT TO:</b>	<b>AUDIT COMMITTEE</b>
<b>DATE:</b>	<b>12 FEBRUARY 2019</b>
<b>SUBJECT:</b>	<b>TREASURY MANAGEMENT STRATEGY STATEMENT 2019/20</b>
<b>LEAD OFFICER:</b>	<b>MARC JONES</b>
<b>CONTACT OFFICER:</b>	<b>GARETH ROBERTS (TEL: EXT 2675)</b>
<b>Nature and reason for reporting</b> For scrutiny - consistent with professional guidance.	

1. This report is presented to ensure that the Council is implementing best practice in accordance with the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice for Treasury Management. The code recommends that prior to being presented for adoption, members should scrutinise the Treasury Management Strategy Statement (which includes the Annual Investment Strategy, the annual MRP Policy Statement, the annual Treasury Management Policy Statement and the Treasury Management Scheme of Delegation). This Authority's scheme of delegation charges the Audit Committee with this function.
  2. The CIPFA Code of Practice on Treasury Management (Section 7) recommends that the Authority's Treasury Management Practices (TMPs) should be approved, documented and monitored. It goes on to state that the nature and extent of the involvement of an organisation's responsible body in approving and monitoring its TMPs and accompanying schedules is a matter for local decision and recognises that in some organisations this may be delegated to the responsible officer. In all cases it should be subjected to scrutiny by the responsible body following recommendations by the responsible officer. This Authority have produced documented TMPs, and were approved by the Audit Committee on 6 December 2016. There was a change to the TMP's in the 2018/19 Treasury Management Strategy Statement which was to increase the minimum cash balance from £5m to £6m in accordance with the latest approved reserve policy.
  3. In terms of updates to the Treasury Management Strategy Statement there are no proposed amendment to the core principals and policies of the 2018/19 Statement.
  4. Under the revised Code of Practice it is now a requirement that the Council prepares a Capital Strategy which takes a longer term view as to the capital investment that is required and how that investment will be funded. This strategy will be approved by the Executive, along with other budget resolutions. This Treasury Management Strategy then sits below the Capital Strategy and considers the impact of that strategy on the Council's borrowing and investments and sets out how both will be undertaken in a controlled way, which is in line with a suitable level of risk which the Council wishes to take bearing in mind the guidance set out in the CIPFA Code of Practice on Treasury Management.
- 5. Recommendations**
- To consider the Treasury Management Strategy for 2019/20 and to make recommendations or note comments for consideration by the Executive Committee.

## TREASURY MANAGEMENT STRATEGY STATEMENT

### ANNUAL INVESTMENT STRATEGY, MINIMUM REVENUE PROVISION POLICY STATEMENT AND TREASURY MANAGEMENT POLICY STATEMENT 2019/20

#### 1. BACKGROUND

**1.1.** CIPFA defines treasury management as:

*“The management of the local authority’s borrowing, investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.”*

The Treasury Management Policy Statement defines the policies and objectives of the treasury management activities (see **Appendix 1**)

**1.2.** The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested with counterparties which meet the criteria in terms of security, liquidity and investment return as set out in this strategy.

**1.3.** The second main function of the treasury management service is the funding of the Council’s capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer-term cash flow planning, to ensure that the Council can meet its capital spending obligations. This management of longer-term cash may involve arranging long or short-term loans, or using longer-term cash flow surpluses. On occasion, when it is prudent and economic, any debt previously drawn may be restructured to meet Council risk or cost objectives.

**1.4.** The contribution the treasury management function makes to the authority is critical, as the balance of debt and investment operations ensure liquidity or the ability to meet spending commitments as they fall due, either on day-to-day revenue or for larger capital projects. The treasury operations will see a balance of the interest costs of debt and the investment income arising from cash deposits affecting the available budget. Since cash balances generally result from reserves and balances, it is paramount to ensure adequate security of the sums invested, as a loss of principal will in effect result in a loss to the Council’s cash reserves.

#### 2. CIPFA CODE OF PRACTICE ON TREASURY MANAGEMENT

**2.1.** The CIPFA Code of Practice on Treasury Management requires the Council to prepare and approve the following documents:-

- A Capital Strategy Statement which sets out a high level, long term overview of capital expenditure and financing, along with details on any associated risks and how they will be managed.
- A Treasury Management Strategy which sets out the Council’s strategy in terms of borrowing and investment which follows on from the capital strategy, sets out the constraints on borrowing, determines a set of prudential indicators and determines the Council’s risk appetite and strategy in respect of investments.

2.2. The key principles of the CIPFA Treasury Management Code of Practice are set out in **Appendix 2**.

### 3. EXTERNAL CONTEXT

3.1. Setting the Treasury Management Strategy cannot be undertaken in isolation, and consideration must be given to the economic situation as this has an impact on investment interest rates, the cost of borrowing and the financial strength of counterparties. A full summary of the economic outlook is set out in **Appendix 3**, but the main points to consider are as follows:-

- Weakening economic growth in the US, China and the Eurozone
- Continued low levels of inflation in the UK with rates being on or close to the Bank of England's target of 2%.
- A potential for interest rates rises from late 2019 onwards.
- Continuing uncertainty surrounding Brexit and its impact on the UK and Eurozone economy.
- Investment returns are likely to remain low during 2019/20 but to be on a gently rising trend over the next few years

3.2. Having considered the available information and having considered the advice from the Council's Treasury Management Advisors, the following table sets out the Council's view on interest rate levels for the following 3 years:-

**Table 1**  
**Prospects for Interest Rates to March 2022**

Annual Average (%)	Bank Rate (%)	PWLB Borrowing Rates (including certainty rate adjustment)		
		5 year	25 year	50 year
December 2018	0.75	2.00	2.90	2.70
March 2019	0.75	2.10	2.90	2.70
June 2019	1.00	2.20	3.00	2.80
September 2019	1.00	2.20	3.10	2.90
December 2019	1.00	2.30	3.10	2.90
March 2020	1.25	2.30	3.20	3.00
June 2020	1.25	2.40	3.30	3.10
September 2020	1.25	2.50	3.30	3.10
December 2020	1.50	2.50	3.40	3.20
March 2021	1.50	2.60	3.40	3.20
June 2021	1.75	2.60	3.50	3.30
September 2021	1.75	2.70	3.50	3.30
December 2021	1.75	2.80	3.60	3.40
March 2022	2.00	2.80	3.60	3.40

Information provided by Link Asset Services is attached as **Appendix 4**.

3.3. Given the forecast for bank base rates, the following rates of return on investments are expected during the financial years:-

2018/19: 0.75%;

2019/20: 1.00%;

2020/21: 1.50%;

2021/22: 1.75%;

2022/23: 1.75%;

2023/24: 2.00%;

2024/25 Onwards: 2.50%

## 4. THE COUNCIL'S CURRENT POSITION

### 4.1. Borrowing

4.1.1. The Council's current external borrowing is set out in Table 2 below. A full analysis is attached as **Appendix 5**.

**Table 2**  
**Summary of the Council's Current Outstanding Loans**

PWLB LOANS						
	PWL / PWLB Maturity	PWLB EIP/ Annuity	Market Loans	PWLB Variable	Total Maturing	
Loan Outstanding	£121,184k	£236k	£0k	£0k	£121,415k	
Average life(years)	24.63	7.61	0.00	0.00	24.60	
Average rate (%)	5.26	9.41	0.00	0.00	5.15	
OTHER LOANS						
	Welsh Government	Salix Loan 1	Salix Loan 2	Salix Loan 3	Salix Loan 4	Total
Outstanding Balance	£88k	£90k	£319k	£635k	£264k	£1,397k
Repayment Date	2020/21	2024/25	2025/26	2028/29	2027/28	
Interest Rate (%)	0.00	0.00	0.00	0.00	0.00	

### 4.2. Investments

4.2.1. Any surplus cash is currently invested in short term deposit and call accounts. The balance invested in these accounts changes daily (balance as at 31 December 2018 was £5.7m).

4.2.2. Under the current treasury management strategy, the council invests surplus cash ensuring first of all the security of the deposit, secondly the liquidity of the deposit and finally the return on the investment. In practice, in order to ensure the first and second principles, the rate of return on investments is sacrificed and the current average return on investments is 0.38%.

## 5. IMPACT OF FUTURE PLANS ON BORROWING

5.1. Capital expenditure is partly funded from borrowing and the capital programme as set out in the Capital Strategy is set out in Table 3 below:-

**Table 3**  
**Proposed Capital Expenditure Programme 2019/20 – 2021/22**

	2019/20 £'000	2020/21 £'000	2021/22 £'000
<b>Non - HRA</b>	<b>14,620</b>	<b>20,321</b>	<b>20,607</b>
<b>HRA</b>	<b>13,110</b>	<b>18,431</b>	<b>19,744</b>
<b>Commercial Activities / Non Financial Investment</b>	<b>3,400</b>	<b>100</b>	<b>0</b>
<b>TOTAL EXPENDITURE</b>	<b>31,130</b>	<b>38,852</b>	<b>40,351</b>
<b>Financed By</b>			
<b>Capital Grants</b>	<b>14,316</b>	<b>12,324</b>	<b>9,424</b>
<b>Capital Receipts</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>Reserves</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>Revenue</b>	<b>9,450</b>	<b>9,471</b>	<b>10,634</b>
<b>Balance Funded from Borrowing</b>	<b>7,364</b>	<b>17,057</b>	<b>20,293</b>

- 5.2.** An important factor to consider is the impact of borrowing on the Council's Capital Financing Requirement (CFR). The CFR is the measure of the Council's underlying borrowing need. Borrowing is not limited to external borrowing from PWLB but also the use of the Council's own cash balances (internal borrowing) which have been used to fund capital expenditure.
- 5.3.** Capital expenditure will increase the CFR but only by the sum that is not funded from grants, capital receipts, reserves or revenue. The CFR will also reduce annually by the sum of the Minimum Revenue Provision (MRP) which is charged to revenue. The level of the CFR is an important measure to ensure that the Council does not commit itself to unaffordable levels of borrowing.
- 5.4.** In order to ensure that the Council has sufficient funds available to repay debt as it falls due, the Council is required to make a charge to the revenue account each year and this charge is known as the Minimum Revenue Provision. Regulations require that the Council approves an MRP statement in advance of each financial year. The policy for 2019/20 is set out in **Appendix 6**. The Council's MRP was substantially revised in 2018 but there are no changes from that revised policy for 2019/20. By making the MRP charge each year, the Council's cash balances are replenished and that in turn reduces the level of internal borrowing.
- 5.5.** The policy will provide an equal charge on borrowing up to 31 March 2018 and for all borrowing after that date, the MRP charge will be based on the useful life of the asset which has been funded from borrowing. e.g. if £1m is borrowed to fund the capital expenditure on an asset that has an asset life of 20 years, the annual MRP in respect of that loan would be £50k per annum. As new borrowing is undertaken it will increase the MRP charge over time and this increase in costs is allowed for in the Council's budgets.
- 5.6.** The impact of the Council's capital expenditure plans and the MRP charge on the CFR and level of external and internal borrowing is shown in Table 4 below.

**Table 4**  
**Capital Financing Requirement and Borrowing 2018/19 to 2021/22**

	2018/19 £'000	2019/20 £'000	2020/21 £'000	2021/22 £'000
<b>Capital Financing Requirement</b>				
<b>Opening Balance of CFR</b>	<b>136,866</b>	<b>141,191</b>	<b>145,101</b>	<b>158,468</b>
Capital Expenditure	32,956	38,130	38,852	40,351
External Capital Grants	(15,605)	(21,316)	(12,324)	(9,424)
Capital Receipts	(1,826)	0	0	0
Revenue Contribution & Reserves	(7,958)	(9,450)	(9,471)	(10,634)
Minimum Revenue Provision	(3,242)	(3,454)	(3,690)	(3,940)
<b>CLOSING BALANCE OF CFR</b>	<b>141,191</b>	<b>145,101</b>	<b>158,468</b>	<b>174,821</b>
<b>External Borrowing</b>				
<b>Opening Balance of External Borrowing</b>	<b>117,029</b>	<b>122,812</b>	<b>124,996</b>	<b>137,339</b>
Borrowing to Fund Capital Expenditure	898	7,364	17,057	20,293
Borrowing to Fund Loan Repayments	5,000	0	0	0
Borrowing to Replace Internal Borrowing	10,000	0	0	0
Loan Repayments	(10,115)	(5,180)	(4,714)	(173)
<b>Closing Balance of External Borrowing</b>	<b>122,812</b>	<b>124,996</b>	<b>137,339</b>	<b>157,459</b>
<b>Internal Borrowing</b>				
<b>Opening Balance of Internal Borrowing</b>	<b>19,837</b>	<b>18,379</b>	<b>20,105</b>	<b>21,129</b>
Replacement of Internal Borrowing	(10,000)	0	0	0
Funding Loan Repayments from Ext. Borrowing	(5,000)	0	0	0
External Loan Repayments	10,115	5,180	4,714	173
Borrowing to Fund Capital Expenditure	6,669	0	0	0
Minimum Revenue Provision	(3,242)	(3,454)	(3,690)	(3,940)
<b>Closing Balance of Internal Borrowing</b>	<b>18,379</b>	<b>20,105</b>	<b>21,129</b>	<b>17,362</b>
<b>TOTAL BORROWING</b>	<b>141,191</b>	<b>145,101</b>	<b>158,468</b>	<b>174,821</b>

## **6. BORROWING STRATEGY**

**6.1.** The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This approach is prudent as investment returns are low and counterparty risk is still an issue that needs to be considered. As part of this strategy the ability to externally borrow to repay the reserves and balances if needed is important. Table 4 indicates that £18.379m may need to be externally borrowed if urgently required. This is the amount of council reserves and balances used in the past to fund the capital programme instead of taking out borrowing.

**6.2.** Against this background and the risks within the economic forecast, caution will be adopted with the 2019/20 treasury operations. The S151 Officer will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:-

- if it was felt that there was a significant risk of a sharp FALL in long and short term rates (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered if it is cost effective to do so.
- If it was felt that there was a significant risk of a much sharper RISE in long and short term rates than that currently forecast, perhaps arising from an acceleration in the start date and in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised. Most likely, fixed rate funding will be drawn whilst interest rates are lower than they are projected to be in the next few years
- Any decisions will be reported to this committee at the next available opportunity.

### **6.3. External v Internal Borrowing**

**6.3.1.** Current conditions indicate a need for a flexible approach to the choice between internal and external borrowing. Many of the factors which lay behind previous policies to externalise all borrowing remain valid, e.g.:-

- With a continuing historically abnormally low Bank Rate and PWLB rates, there remains a unique opportunity for local authorities to actively manage their strategy of undertaking new external borrowing.

**6.3.2.** However, it remains the case that there are certain limitations to this approach, as previously noted, e.g.:-

- The policy can cause exposure to credit risk (e.g. risk of the bank defaulting on the debt), so this aspect must be very carefully managed;
- Careful on going consideration needs to be given to the difference between borrowing rates and investment rates to ensure the Council obtains value for money once an appropriate level of risk management has been attained to ensure the security of its investments.

**6.3.3.** In favour of internalisation, over the medium term investment rates are expected to continue to be below long term borrowing rates. This means that value for money considerations would indicate that value could best be obtained by avoiding new external borrowing and by using internal cash balances to finance new capital expenditure, or to replace maturing external debt (this is referred to as internal borrowing). This would maximise short term savings.

- 6.3.4.** However, short term savings by avoiding new long term external borrowing in 2018/19 must also be weighed against the potential for incurring additional long term extra costs, by delaying unavoidable new external borrowing until later years when PWLB long term rates are forecast to be higher. Additionally, the cash flow implications of internalising borrowing require regular review and will limit the potential extent of internalising borrowing.
- 6.3.5.** Against this background, caution will be adopted with the 2019/20 treasury operations. The S151 Officer will monitor the interest rate market and adopt a pragmatic approach to changing circumstances, reporting any decisions to the appropriate decision making body at the earliest opportunity.

#### **6.4. Borrowing in Advance of Need**

- 6.4.1.** The Council will not borrow more than, or in advance of, its needs, solely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.
- 6.4.2.** In determining whether borrowing will be undertaken in advance of need the Council will:-
1. ensure that there is a clear link between the capital programme and maturity profile of the existing debt portfolio which supports the need to take funding in advance of need;
  2. ensure the ongoing revenue liabilities created, and the implications for the future plans and budgets, have been considered;
  3. evaluate the economic and market factors that might influence the manner and timing of any decision to borrow;
  4. consider the advantages and disadvantages of alternative forms of funding;
  5. consider the alternative interest rate bases available, the most appropriate periods to fund and repayment profiles to use; and
  6. consider the impact of borrowing in advance on temporarily (until required to finance capital expenditure) increasing investment cash balances and the consequent increase in exposure to counterparty risk, and other risks, and the level of such risks given the controls in place to minimise them.
- 6.4.3.** Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism.

#### **6.5. Debt Rescheduling**

- 6.5.1.** As short term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (i.e. premiums incurred).



**6.5.2.** The reasons for any rescheduling to take place will include:-

- the generation of cash savings and/or discounted cash flow savings;
- helping to fulfil the treasury strategy; and
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

**6.5.3.** Consideration will also be given to identify if there is any residual potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.

**6.5.4.** All rescheduling will be reported to the Audit Committee, at the earliest practicable meeting following its action.

## **6.6. Debt Profile**

**6.6.1.** As can be seen from **Appendix 5**, the existing borrowing is due to be repaid in various years up to 2068/69. As part of any decision on future borrowing, the Council will aim to ensure that the repayment date is arranged so as to smooth out repayments as far as possible, but priority will be given to the interest rate payable when determining the type of loan (maturity or annuity) and the length of the loan.

## **7. INVESTMENT STRATEGY**

**7.1.** In-house funds: Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months). Greater returns are usually obtainable by investing for longer periods. While most cash balances are required in order to manage the ups and downs of cash flow where cash sums can be identified that could be invested for longer periods, the value to be obtained from longer term investments will be carefully assessed.

- If it is thought that Bank Rate is likely to rise significantly within the time horizon being considered, then consideration will be given to keeping most investments as being short term or variable.
- Conversely, if it is thought that Bank Rate is likely to fall within that time period, consideration will be given to locking in higher rates currently obtainable, for longer periods.

## **7.2. Management of Risk**

**7.2.1.** CIPFA has extended the meaning of 'investments' to include both financial and non-financial investments. This report deals solely with financial investments, (as managed by the treasury management team). Non-financial investments, essentially the purchase of income yielding assets, are covered in the Capital Strategy, (a separate report).

**7.2.2.** The Council's investment policy has regard to the following:-

- Welsh Government's Guidance on Local Government Investments ("the Guidance")
- CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2017 ("the Code")
- CIPFA Treasury Management Guidance Notes 2018
- The Council's investment priorities will be security first, portfolio liquidity second and then yield, (return).

**7.2.3.** The above guidance from the Welsh Government and CIPFA place a high priority on the management of risk. This authority has adopted a prudent approach to managing risk and defines its risk appetite by the following means: -

1. Minimum acceptable **credit criteria** are applied in order to generate a list of highly creditworthy counterparties. This also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the short term and long-term ratings.
2. **Other information:** ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To achieve this consideration the Council will engage with its advisors to maintain a monitor on market pricing such as “**credit default swaps**” and overlay that information on top of the credit ratings.
3. **Other information** sources used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.
4. This authority has defined the list of **types of investment instruments** that the treasury management team are authorised to use. There are two lists in **Appendix 7** under the categories of ‘specified’ and ‘non-specified’ investments.
  - **Specified investments** are those with a high level of credit quality and subject to a maturity limit of one year.
  - **Non-specified investments** are those with less high credit quality, may be for periods in excess of one year, and/or are more complex instruments which require greater consideration by members and officers before being authorised for use.
5. **Non-specified investments limit.** The Council has determined that it will limit the maximum total exposure to non-specified investments as being X% of the total investment portfolio,
6. **Lending limits**, (amounts and maturity), for each counterparty will be set through applying the matrix table as set out in the Creditworthiness section of this strategy.
7. **Transaction limits** are set for each type of investment in **Appendix 8**.
8. This authority will set a limit for the amount of its investments which are invested for **longer than 365 days**, (see paragraph 7.1).
9. Investments will only be placed with counterparties from countries with a specified minimum **sovereign rating**, (see paragraph 7.x).
10. This authority has engaged **external consultants**, to provide expert advice on how to optimise an appropriate balance of security, liquidity and yield, given the risk appetite of this authority in the context of the expected level of cash balances and need for liquidity throughout the year.
11. All investments will be denominated in **sterling**.

12. As a result of the change in accounting standards for 2018/19 under **IFRS 9**, this authority will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund.

### 7.3. Creditworthiness Policy

- 7.3.1. The primary principle governing the Council's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle, the Council will ensure that:-
- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the specified and non-specified investment sections below; and
  - It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council's prudential indicators covering the maximum principal sums invested.
- 7.3.2. The S151 Officer will maintain a counterparty list in compliance with the criteria set out in **Appendix 8** and will revise the criteria and submit them to Council for approval as necessary. These criteria are separate to that which determines which types of investment instrument are either specified or non-specified as it provides an overall pool of counterparties considered high quality which the Council may use, rather than defining what types of investment instruments are to be used.
- 7.3.3. Credit rating information is supplied by Link Asset Services, our treasury consultants, on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating Watches (notification of a likely change), rating Outlooks (notification of the longer term bias outside the central rating view) are provided to officers almost immediately after they occur and this information is considered before dealing. For instance, a negative rating Watch applying to a counterparty at the minimum Council criteria will be suspended from use, with all others being reviewed in light of market conditions.
- 7.3.4. All credit ratings will be monitored daily. The Council is alerted to changes to ratings of all three agencies through its use of the Capita creditworthiness service.
- 7.3.5. As an additional layer to the minimum credit rating criteria described above, this Council also employs the creditworthiness service provided by Link Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard and Poor's. The credit ratings of counterparties are supplemented with the following overlays:-

- Credit watches and credit outlooks from credit rating agencies;
- Credit Default Swaps (CDS) spreads to give early warning of likely changes in credit ratings;
- Sovereign ratings to select counterparties from only the most creditworthy countries.

**7.3.6.** This modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads from which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council at the discretion of the S151 Officer, to assist in determining the duration for investments. The Council will, therefore, normally use counterparties within the following durational bands:-

Yellow:	5 years *
Dark pink :	5 years for Ultra-Short Dated Bond Funds with a credit score of 1.25
Light pink :	5 years for Ultra-Short Dated Bond Funds with a credit score of 1.5
Purple:	2 years
Blue:	1 year (only applies to nationalised or semi nationalised UK Banks)
Orange:	1 year
Red:	6 months
Green:	100 days
No colour:	not to be used

**7.3.7.** The Link Asset Services creditworthiness service uses a wider array of information than just primary ratings and, by using a risk weighted scoring system, does not give undue preponderance to just one agency's ratings.

**7.3.8.** Typically the minimum credit ratings criteria the Council use will be a Short Term rating (Fitch or equivalents) of F1 and a Long Term rating of A-. There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but may still be used. In these instances, consideration will be given to the whole range of ratings available, or other topical market information, to support their use.

**7.3.9.** All credit ratings will be monitored weekly. The Council is alerted to changes to ratings of all three agencies through its use of the Link Asset Services' creditworthiness service.

- if a downgrade results in the counterparty / investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.
- in addition to the use of credit ratings the Council will be advised of information in movements in credit default swap spreads against the iTraxx benchmark and other market data on a daily basis via its Passport website, provided exclusively to it by Link Asset Services. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.

•

**7.3.10.** Sole reliance will not be placed on the use of this external service. In addition this Council will also use market data and market information, information on any external support for banks to help support its decision making process.

**7.3.11.** The largest UK banks, (those with more than £25bn of retail / Small and Medium-sized Enterprise (SME) deposits), are required, by UK law, to separate core retail banking services from their investment and international banking activities by 1st January 2019. This is known as “ring-fencing”. Whilst smaller banks with less than £25bn in deposits are exempt, they can choose to opt up. Several banks are very close to the threshold already and so may come into scope in the future regardless.

**7.3.12.** Ring-fencing is a regulatory initiative created in response to the global financial crisis. It mandates the separation of retail and SME deposits from investment banking, in order to improve the resilience and resolvability of banks by changing their structure. In general, simpler, activities offered from within a ring-fenced bank, (RFB), will be focused on lower risk, day-to-day core transactions, whilst more complex and “riskier” activities are required to be housed in a separate entity, a non-ring-fenced bank, (NRFB). This is intended to ensure that an entity’s core activities are not adversely affected by the acts or omissions of other members of its group.

**7.3.13.** While the structure of the banks included within this process may have changed, the fundamentals of credit assessment have not. The Council will continue to assess the new-formed entities in the same way that it does others and those with sufficiently high ratings, (and any other metrics considered), will be considered for investment purposes.

#### **7.4. Country Limits**

**7.4.1.** The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA- from Fitch Ratings (or equivalent from other agencies if Fitch does not provide). The list of countries that qualify using this credit criteria as at the date of this report are shown in **Appendix 9**. This list will be added to or deducted from by officers should ratings change in accordance with this policy.

### **8. GOVERNANCE AND CONTROL**

**8.1.** The Prudential Code reflects a move towards self regulation for local authorities and effective corporate governance is one of the key elements to the successful implementation of the Code.

**8.2.** Corporate Governance includes the following elements:-

- A formal role for the Section 151 Officer
- Setting and monitoring of Prudential and Treasury Indicators
- A scheme of delegation and a process of formal approval
- Reporting on Treasury Management matters to Members

#### **8.3. Role of the Section 151 Officer and Members**

**8.3.1.** The Section 151 Officer is responsible for ensuring that matters relating to Treasury Management and Capital Financing are taken into account and reported to the Executive / Full Council for consideration and that procedures are established to monitor performance.

- 8.3.2.** The Section 151 must ensure that prudential indicators are set and monitored in order to demonstrate the legislative requirement that the Council's financial plans are affordable.
- 8.3.3.** Members also play an important role in not just authorising the relevant decisions but also in scrutinising treasury management processes, decisions and performance. In order to undertake this role The CIPFA Code requires the responsible officer to ensure that Members with responsibility for treasury management receive adequate training in treasury management. This especially applies to Members responsible for scrutiny. In order to support the scrutiny role of the members of the Audit and Governance Committee, the committee's members received training in treasury management, delivered by the appointed treasury management consultants on November 8 2017. Further training will be arranged when required. The training needs of treasury management officers are regularly reviewed and addressed.
- 8.3.4.** The Treasury Management Scheme of Delegation and a fuller explanation of the role of the Section 151 Officer is set out in **Appendix 10**.

#### **8.4. Treasury Management Advice**

- 8.4.1.** The Council uses The Link Asset Services as its external treasury management advisors. In accordance with procurement regulations the Treasury Management advisory service were advertised for tender for the period 1 April 2016 to 31 March 2019 with an option to extend for 2 years, with Link Asset Services (previously Capita Asset Services) being the successful tender.
- 8.4.2.** The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers. All decisions will be undertaken with regards to all available information, including, but not solely, our treasury advisers. Final responsibility for treasury management decisions remains with the Council.
- 8.4.3.** It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

#### **8.5. Prudential and Treasury Indicators**

- 8.5.1.** The Prudential and Treasury Indicators set out in **Appendix 11** cover affordability, prudence and sets out limits for capital expenditure, external debt and the structure of the debt. It is for the Council to set the Prudential Indicators and it is important to not just to consider the indicators for each individual year in isolation but also to consider the past performance and the future forecasts. A fuller explanation of the purpose of each indicator is set out in **Appendix 12**.

#### **8.6. Reporting**

- 8.6.1.** The Council is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of policies, estimates and actuals. These reports are required to be adequately scrutinised by committee before being recommended to the Council. This role is undertaken by the Audit and Governance Committee.
- 8.6.2.** Prudential and Treasury Management Indicators and Treasury Strategy - The first and most important report (this report) covers:-
- the Treasury Management Strategy (how the investments and borrowings are to be organised) including treasury management indicators;
  - an Investment Strategy (the parameters on how investments are to be managed);

- a Minimum Revenue Provision (MRP) Policy (how residual capital expenditure is charged to revenue over time);
- a Treasury Management Policy Statement (definition of the policies and objectives of the treasury management function); and
- the capital plans (including the associated prudential indicators).

**8.6.3.** A Mid-Year Treasury Management Report - This will update members with the progress of the capital position, amending prudential indicators as necessary, and whether the treasury strategy is meeting its objectives or whether any policies require revision.

**8.6.4.** An Annual Treasury Report - This is a backward looking review document and provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

## **APPENDICES**

1. Treasury Management Policy Statement
2. Treasury Management Key Principles
3. Economic background
4. Interest rate forecasts
5. Loan maturity profile
6. MRP Policy Statement
7. Specified and non-specified investments
8. Counterparty criteria
9. Approved countries for investments
10. Treasury management scheme of delegation and the role of the section 151 officer.
11. Prudential and Treasury Indicators
12. Explanation of Prudential Indicators
13. Glossary of and information on Prudential & Treasury Management indicators

**Treasury Management Policy Statement**

1. CIPFA defines its treasury management activities as: “The management of the authority’s investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks”.
2. This organisation regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation, and any financial instruments entered into to manage these risks.
3. This organisation acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.



## The CIPFA Treasury Management in the Public Services: Code of Practice

The key principles of CIPFA's *Treasury Management in the Public Services: Code of Practice (2011 Edition)*, as described in Section 4 of that Code are as follows:-

### Key Principle 1:

Public service organisations should put in place formal and comprehensive objectives, policies and practices, strategies and reporting arrangements for the effective management and control of their treasury management activities.

### Key Principle 2:

Their policies and practices should make clear that the effective management and control of risks are prime objectives of their treasury management activities and that responsibility for these lies clearly within their organisations. Their appetite for risk should form part of their annual strategy, including any use of financial instruments for the prudent management of those risks, and should ensure that priority is given to security and liquidity when investing funds.

### Key Principle 3:

They should acknowledge that the pursuit of value for money in treasury management and the use of suitable performance measures are valid and important tools for responsible organisations to employ in support of their business and service objectives; and that, within the context of effective risk management, their treasury management policies and practices should reflect this.

The Code then goes on to say that:

"In framing these recommendations, CIPFA acknowledges the difficulties of striving for effective risk management and control, whilst at the same time pursuing value for money. This code does not seek to be prescriptive about how this issue should be handled, particularly since it covers such a wide variety of organisations. However, where appropriate, the sector specific guidance notes give suitable advice. CIPFA recognises that no two organisations in the public services are likely to tackle this issue in precisely the same manner but success in this area of treasury management is likely to be viewed, especially in value for money terms, as an indicator of a strongly performing treasury management function."

"Even though it dates back to 1991, CIPFA considers that the report by the Treasury and Civil Service Committee of the House of Commons on the BCCI closure is still pertinent, wherein it was stated that:"

*"In balancing risk against return, local authorities should be more concerned to avoid risks than to maximise returns."*

"Indeed this view was supported by the Communities and Local Government Select Committee report into local authority investments in 2009."

"It is CIPFA's view that throughout the public services the priority is to protect capital rather than to maximise return. The avoidance of all risk is neither appropriate nor possible. However, a balance must be struck with a keen responsibility for public money."

Accordingly the Authority will adopt, as part of the standing orders, the following four clauses;

1. The Authority will create and maintain, as the cornerstones for effective treasury management:
  - a treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury management activities; and
  - suitable treasury management practices (TMPs) setting out the manner in which the Authority will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.

The content of the Policy Statement and TMPs will follow the recommendations contained in Sections 6 and 7 of the Code, subject only to amendment where necessary to reflect the particular circumstances of the Authority. Such amendments will not result in the Authority materially deviating from the Code's key principles.

2. The County Council, Executive Committee and the Audit Committee will receive reports on the Authority's treasury management policies, practices and activities, including; an annual strategy and plan in advance of the year, a mid-year review report and an annual report after its close, in the form prescribed in the TMPs.
3. The County Council/Executive Committee are responsible for the implementation of the Authority's treasury management policies and practices in accordance with the Treasury Management Scheme of Delegation. The S151 Officer is responsible for the execution and administration of treasury management decisions, who will act in accordance with the Authority's policy statement and TMPs and, if he/she is a CIPFA member, CIPFA's Standard of Professional Practice on Treasury Management.
4. The Authority nominates Audit Committee to be responsible for ensuring effective scrutiny of treasury management strategy and policies.

## Economic Background

**GLOBAL OUTLOOK.** **World growth** has been doing reasonably well, aided by strong growth in the US. However, US growth is likely to fall back in 2019 and, together with weakening economic activity in China and the eurozone, overall world growth is likely to weaken.

**Inflation** has been weak during 2018 but, at long last, unemployment falling to remarkably low levels in the US and UK has led to an acceleration of wage inflation. The US Fed has therefore increased rates nine times and the Bank of England twice. However, the ECB is unlikely to start raising rates until late in 2019 at the earliest.

### KEY RISKS - central bank monetary policy measures

Looking back on nearly ten years since the financial crash of 2008 when liquidity suddenly dried up in financial markets, it can be assessed that central banks' monetary policy measures to counter the sharp world recession were successful. The key monetary policy measures they used were a combination of lowering central interest rates and flooding financial markets with liquidity, particularly through unconventional means such as quantitative easing (QE), where central banks bought large amounts of central government debt and smaller sums of other debt.

**The key issue now** is that period of stimulating economic recovery and warding off the threat of deflation, is coming towards its close. A new period is well advanced in the US, and started more recently in the UK, of reversing those measures i.e. by raising central rates and, (for the US), reducing central banks' holdings of government and other debt. These measures are now required in order to stop the trend of a reduction in spare capacity in the economy and of unemployment falling to such low levels, that the re-emergence of inflation is viewed as a major risk. It is, therefore, crucial that central banks get their timing right and do not cause shocks to market expectations that could destabilise financial markets. In particular, a key risk is that because QE-driven purchases of bonds drove up the price of government debt, and therefore caused a sharp drop in income yields, this also encouraged investors into a search for yield and into investing in riskier assets such as equities. Consequently, prices in both bond and equity markets rose to historically high valuation levels simultaneously. This meant that both asset categories were exposed to the risk of a sharp downward correction and we did, indeed, see a sharp fall in equity values in the last quarter of 2018. It is important, therefore, that central banks only gradually unwind their holdings of bonds in order to prevent destabilising the financial markets. It is also likely that the timeframe for central banks unwinding their holdings of QE debt purchases will be over several years. They need to balance their timing to neither squash economic recovery, by taking too rapid and too strong action, or, conversely, let inflation run away by taking action that was too slow and/or too weak. **The potential for central banks to get this timing and strength of action wrong are now key risks.** At the time of writing, (early January 2019), financial markets are very concerned that the Fed is being too aggressive with its policy for raising interest rates and is likely to cause a recession in the US economy.

The world economy also needs to adjust to a sharp change in **liquidity creation** over the last five years where the US has moved from boosting liquidity by QE purchases, to reducing its holdings of debt (currently about \$50bn per month). In addition, the European Central Bank ended its QE purchases in December 2018.

**UK.** The flow of positive economic statistics since the end of the first quarter of 2018 has shown that pessimism was overdone about the poor growth in quarter 1 when adverse weather caused a temporary downward blip. Quarter 1 at 0.1% growth in GDP was followed by a return to 0.4% in quarter 2 and by a strong performance in quarter 3 of +0.6%. However, growth in quarter 4 is expected to weaken significantly.

At their November quarterly Inflation Report meeting, the MPC repeated their well-worn phrase that future Bank Rate increases would be gradual and would rise to a much lower equilibrium rate, (where monetary policy is neither expansionary or contractionary), than before the crash; indeed they gave a figure for this of around 2.5% in ten years' time, but declined to give a medium term forecast. However, with so much uncertainty around Brexit, they warned that the next move could be up or down, even if there was a disorderly Brexit. While it would be expected that Bank Rate could be cut if there was a significant fall in GDP growth as a result of a disorderly Brexit, so as to provide a stimulus to growth, they warned they could also raise Bank Rate in the same scenario if there was a boost to inflation from a devaluation of sterling, increases in import prices and more expensive goods produced in the UK replacing cheaper goods previously imported, and so on. In addition, the Chancellor could potentially provide fiscal stimulus to support economic growth, though at the cost of increasing the budget deficit above currently projected levels.

It is unlikely that the MPC would increase Bank Rate in February 2019, ahead of the deadline in March for Brexit. Getting parliamentary approval for a Brexit agreement on both sides of the Channel will take well into spring 2019. However, in view of the hawkish stance of the MPC at their November meeting, the next increase in Bank Rate is now forecast to be in May 2019, (on the assumption that a Brexit deal is agreed by both the UK and the EU). The following increases are then forecast to be in February and November 2020 before ending up at 2.0% in February 2022.

**Inflation.** The Consumer Price Index (CPI) measure of inflation has been falling from a peak of 3.1% in November 2017 to 2.1% in December 2018. In the November Bank of England quarterly Inflation Report, inflation was forecast to still be marginally above its 2% inflation target two years ahead, (at about 2.1%), given a scenario of minimal increases in Bank Rate.

As for the **labour market** figures in October, unemployment at 4.1% was marginally above a 43 year low of 4% on the Independent Labour Organisation measure. A combination of job vacancies hitting an all-time high, together with negligible growth in total employment numbers, indicates that employers are now having major difficulties filling job vacancies with suitable staff. It was therefore unsurprising that wage inflation picked up to 3.3%, (3 month average regular pay, excluding bonuses). This meant that in real terms, (i.e. wage rates less CPI inflation), earnings are currently growing by about 1.2%, the highest level since 2009. This increase in household spending power is likely to feed through into providing some support to the overall rate of economic growth in the coming months. This tends to confirm that the MPC was right to start on a cautious increase in Bank Rate in August as it views wage inflation in excess of 3% as increasing inflationary pressures within the UK economy.

In the **political arena**, the Brexit deal put forward by the Conservative minority government was defeated on 15 January. It is unclear at the time of writing, how this situation will move forward. *(Officers are likely to need to verbally update members as events are constantly evolving.)* However, our central position is that Prime Minister May's government will endure, despite various setbacks, along the route to reaching an orderly Brexit though the risks are increasing that it may not be possible to get full agreement by the UK and EU before 29 March 2019, in which case this withdrawal date is likely to be pushed back to a new date. If, however, the UK faces a general election in the next 12 months, this could result in a potential loosening of monetary and fiscal policy and therefore medium to longer dated gilt yields could rise on the expectation of a weak pound and concerns around inflation picking up.

**USA.** President Trump's massive easing of fiscal policy is fuelling a (temporary) boost in consumption which has generated an upturn in the rate of strong growth which rose from 2.2% (annualised rate) in quarter 1 to 4.2% in quarter 2 and 3.5%, (3.0% y/y), in quarter 3, but also an upturn in inflationary pressures. The strong growth in employment numbers and the reduction in the unemployment rate to 3.9%, near to a recent 49 year low, has fed through to an upturn in wage inflation which hit 3.2% in November. However, CPI inflation overall fell to 2.2% in November and looks to be on a falling trend to drop below the Fed's target of 2% during 2019. The Fed has continued on its series of increases in interest rates with another 0.25% increase in December to between 2.25% and 2.50%, this being the fifth increase in 2018 and the ninth in this cycle. However, they did also reduce their forecast for further increases from three to two. This latest increase compounded investor fears that the Fed is over doing the speed and level of increases in rates and that it is going to cause a US recession as a result. There is also much evidence in previous monetary policy cycles of the Fed's series of increases doing exactly that. Consequently, we have seen stock markets around the world falling under the weight of fears around the Fed's actions, the trade war between the US and China and an expectation that world growth will slow.

The tariff war between the US and China has been generating a lot of heat during 2018, but it is not expected that the current level of actual action would have much in the way of a significant effect on US or world growth. However, there is a risk of escalation if an agreement is not reached soon between the US and China.

**Eurozone.** Growth was 0.4% in quarters 1 and 2 but fell back to 0.2% in quarter 3, though this was probably just a temporary dip. In particular, data from Germany has been mixed and it could be negatively impacted by US tariffs on a significant part of its manufacturing exports e.g. cars. For that reason, although growth is still expected to be in the region of nearly 2% for 2018, the horizon is less clear than it seemed just a short while ago. Having halved its quantitative easing purchases of debt in October 2018 to €15bn per month, the European Central Bank ended all further purchases in December 2018. The ECB is forecasting inflation to be a little below its 2% top limit through the next three years so it may find it difficult to warrant a start on raising rates by the end of 2019 if the growth rate of the EU economy is on a weakening trend.

**China.** Economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium term risks are increasing. Major progress still needs to be made to eliminate excess industrial capacity and the stock of unsold property, and to address the level of non-performing loans in the banking and credit systems. Progress has been made in reducing the rate of credit creation, particularly from the shadow banking sector, which is feeding through into lower economic growth. There are concerns that official economic statistics are inflating the published rate of growth.

**Japan** - has been struggling to stimulate consistent significant GDP growth and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy. It is likely that loose monetary policy will endure for some years yet to try to stimulate growth and modest inflation.

**Emerging countries.** Argentina and Turkey are currently experiencing major headwinds

and are facing challenges in external financing requirements well in excess of their reserves of foreign exchange. However, these countries are small in terms of the overall world economy, (around 1% each), so the fallout from the expected recessions in these countries will be minimal.

## INTEREST RATE FORECASTS

The interest rate forecasts provided by Link Asset Services in paragraph 3.2 are **predicated on an assumption of an agreement being reached on Brexit between the UK and the EU**. On this basis, while GDP growth is likely to be subdued in 2019 due to all the uncertainties around Brexit depressing consumer and business confidence, an agreement is likely to lead to a boost to the rate of growth in 2020 which could, in turn, increase inflationary pressures in the economy and so cause the Bank of England to resume a series of gentle increases in Bank Rate. Just how fast, and how far, those increases will occur and rise to, will be data dependent. The forecasts in this report assume a modest recovery in the rate and timing of stronger growth and in the corresponding response by the Bank in raising rates.

- In the event of an **orderly non-agreement exit**, it is likely that the Bank of England would take action to cut Bank Rate from 0.75% in order to help economic growth deal with the adverse effects of this situation. This is also likely to cause short to medium term gilt yields to fall.
- If there was a **disorderly Brexit**, then any cut in Bank Rate would be likely to last for a longer period and also depress short and medium gilt yields correspondingly. It is also possible that the government could act to protect economic growth by implementing fiscal stimulus.

However, there would appear to be a majority consensus in the Commons against any form of non-agreement exit so the chance of this occurring has now substantially diminished.

### The balance of risks to the UK

- The overall balance of risks to economic growth in the UK is probably neutral.
- The balance of risks to increases in Bank Rate and shorter term PWLB rates, are probably also even and are broadly dependent on how strong GDP growth turns out, how slowly inflation pressures subside, and how quickly the Brexit negotiations move forward positively.

One risk that is both an upside and downside risk, is that all central banks are now working in very different economic conditions than before the 2008 financial crash as there has been a major increase in consumer and other debt due to the exceptionally low levels of borrowing rates that have prevailed for ten years since 2008. This means that the neutral rate of interest in an economy, (i.e. the rate that is neither expansionary nor deflationary), is difficult to determine definitively in this new environment, although central banks have made statements that they expect it to be much lower than before 2008. Central banks could therefore either over or under do increases in central interest rates.

### Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

- **Brexit** – if it were to cause significant economic disruption and a major downturn in the rate of growth.
- **Bank of England monetary policy** takes action too quickly, or too far, over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
- A resurgence of the **eurozone sovereign debt crisis**, possibly in **Italy**, due to its high level of government debt, low rate of economic growth and vulnerable banking system, and due to the election in March of a government which has made a lot of anti-austerity noise. The EU rejected the initial proposed Italian budget and demanded cuts in government spending which the Italian government initially refused. However, a fudge was subsequently agreed, but only by *delaying* the planned increases in expenditure to a later year. This can have therefore only been kicked down the road to a later time. The rating agencies have started on downgrading Italian debt to one notch above junk level. If Italian debt were to fall below investment grade, many investors would be unable to hold it. Unsurprisingly, investors are becoming increasingly concerned by the words and actions of the Italian government and consequently, Italian bond yields have risen – at a time when the government faces having to refinance large amounts of debt maturing in 2019.

- **Weak capitalisation of some European banks.** Italian banks are particularly vulnerable; one factor is that they hold a high level of Italian government debt - debt which is falling in value. This is therefore undermining their capital ratios and raises the question of whether they will need to raise fresh capital to plug the gap.
- **German minority government.** In the German general election of September 2017, Angela Merkel's CDU party was left in a vulnerable minority position dependent on the fractious support of the SPD party, as a result of the rise in popularity of the anti-immigration AfD party. Then in October 2018, the results of the Bavarian and Hesse state elections radically undermined the SPD party and showed a sharp fall in support for the CDU. As a result, the SPD is reviewing whether it can continue to support a coalition that is so damaging to its electoral popularity. After the result of the Hesse state election, Angela Merkel announced that she would not stand for re-election as CDU party leader at her party's convention in December 2018, (a new party leader has now been elected). However, this makes little practical difference as she is still expected to aim to continue for now as the Chancellor. However, there are five more state elections coming up in 2019 and EU parliamentary elections in May/June; these could result in a further loss of electoral support for both the CDU and SPD which could also undermine her leadership.
- **Other minority eurozone governments.** Spain, Portugal, Ireland, the Netherlands and Belgium all have vulnerable minority governments dependent on coalitions which could prove fragile. Sweden is also struggling to form a government due to the anti-immigration party holding the balance of power, and which no other party is willing to form a coalition with. The Belgian coalition collapsed in December 2018 but a minority caretaker government has been appointed until the May EU wide general elections.
- **Austria, the Czech Republic and Hungary** now form a strongly anti-immigration bloc within the EU while **Italy**, in 2018, also elected a strongly anti-immigration government. Elections to the EU parliament are due in May/June 2019.
- Further increases in interest rates in the US could spark a **sudden flight of investment funds** from more risky assets e.g. shares, into bonds yielding a much improved yield. Throughout the last quarter of 2018, we saw sharp falls in equity markets interspersed with occasional partial rallies. Emerging countries which have borrowed heavily in dollar denominated debt, could be particularly exposed to this risk of an investor flight to safe havens e.g. UK gilts.
- There are concerns around the level of **US corporate debt** which has swollen massively during the period of low borrowing rates in order to finance mergers and acquisitions. This has resulted in the debt of many large corporations being downgraded to a BBB credit rating, close to junk status. Indeed, 48% of total investment grade corporate debt is now rated at BBB. If such corporations fail to generate profits and cash flow to reduce their debt levels as expected, this could tip their debt into junk ratings which will increase their cost of financing and further negatively impact profits and cash flow.
- **Geopolitical risks**, especially North Korea, but also in Europe and the Middle East, which could lead to increasing safe haven flows.

#### Upside risks to current forecasts for UK gilt yields and PWLB rates

- **Brexit** – if both sides were to agree by 29 March a compromise that quickly removed all threats of economic and political disruption and so led to an early boost to UK economic growth.
- **The Fed causing a sudden shock in financial markets** through misjudging the pace and strength of increases in its Fed Funds Rate and in the pace and strength of reversal of QE, which then leads to a fundamental reassessment by investors of the relative risks of holding bonds, as opposed to equities. This could lead to a major flight from bonds to equities and a sharp increase in bond yields in the US, which could then spill over into impacting bond yields around the world.
- The **Bank of England is too slow** in its pace and strength of increases in Bank Rate and, therefore, allows inflation pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than we currently expect.

**UK inflation**, whether domestically generated or imported, returning to sustained significantly higher levels causing an increase in the inflation premium inherent to gilt yields.

### Brexit timetable and process

- March 2017: UK government notified the European Council of its intention to leave under the Treaty on European Union Article 50 on 29 March 2019.
- 25.11.18 EU27 leaders endorsed the withdrawal agreement
- Dec 2018 vote in the UK Parliament on the agreement was postponed
- 21.12.18 – 8.1.19 UK parliamentary recess
- 15.1.19 Brexit deal defeated in the Commons vote by a large margin
- By 29.3.19 second vote (?) in UK parliament
- By 29.3.19 if the UK Parliament approves a deal, then ratification by the EU Parliament requires a simple majority
- By 29.3.19 if the UK and EU parliaments agree the deal, the EU Council needs to approve the deal; 20 countries representing 65% of the EU population must agree
- 29.3.19 Either the UK leaves the EU, or asks the EU for agreement to an extension of the Article 50 period if the UK Parliament has been unable to agree on a Brexit deal.
- 29.3.19: if an agreement is reached with the EU on the terms of Brexit, then this will be followed by a proposed **transitional period ending around December 2020**.
- UK continues as a full EU member until March 2019 with access to the single market and tariff free trade between the EU and UK. Different sectors of the UK economy may leave the single market and tariff free trade at different times during the transitional period.
- The UK and EU would attempt to negotiate, among other agreements, a bi-lateral trade agreement over that period.
- The UK would aim for a negotiated agreed withdrawal from the EU, although the UK could also exit without any such agreements in the event of a breakdown of negotiations.
- If the UK exits without an agreed deal with the EU, World Trade Organisation rules and tariffs could apply to trade between the UK and EU - but this is not certain.
- On full exit from the EU: the UK parliament would repeal the 1972 European Communities Act.



## Rhagolygon Graddfeydd Llog 2019/2022

### Interest Rate Forecasts 2019/2022

PWLB rates and forecast shown below have taken into account the 20 basis point certainty rate reduction effective as of the 1st November 2012.

Link Asset Services Interest Rate View													
	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
Bank Rate View	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%	1.50%	1.50%	1.75%	1.75%	1.75%	2.00%
3 Month LIBID	0.90%	1.00%	1.10%	1.20%	1.30%	1.40%	1.50%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%
6 Month LIBID	1.00%	1.20%	1.30%	1.40%	1.50%	1.60%	1.70%	1.70%	1.80%	1.90%	2.00%	2.10%	2.20%
12 Month LIBID	1.20%	1.30%	1.40%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%	2.10%	2.20%	2.30%	2.40%
5yr PWLB Rate	2.10%	2.20%	2.20%	2.30%	2.30%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%	2.80%	2.80%
10yr PWLB Rate	2.50%	2.60%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%
25yr PWLB Rate	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%	3.50%	3.50%	3.60%	3.60%
50yr PWLB Rate	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%	3.40%
<b>Bank Rate</b>													
Link Asset Services	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%	1.50%	1.50%	1.75%	1.75%	1.75%	2.00%
Capital Economics	0.75%	1.00%	1.25%	1.50%	1.70%	1.75%	2.00%	2.00%	-	-	-	-	-
<b>5yr PWLB Rate</b>													
Link Asset Services	2.10%	2.20%	2.20%	2.30%	2.30%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%	2.80%	2.80%
Capital Economics	2.03%	2.15%	2.40%	2.65%	2.70%	2.75%	2.80%	2.85%	-	-	-	-	-
<b>10yr PWLB Rate</b>													
Link Asset Services	2.50%	2.60%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%
Capital Economics	2.43%	2.55%	2.80%	3.05%	3.05%	3.05%	3.05%	3.05%	-	-	-	-	-
<b>25yr PWLB Rate</b>													
Link Asset Services	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%	3.50%	3.50%	3.60%	3.60%
Capital Economics	2.96%	3.08%	3.33%	3.58%	3.53%	3.48%	3.43%	3.38%	-	-	-	-	-
<b>50yr PWLB Rate</b>													
Link Asset Services	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%	3.40%
Capital Economics	2.78%	2.90%	3.15%	3.40%	3.40%	3.40%	3.40%	3.40%	-	-	-	-	-

*Rhan o gyngor dderbyniwyd gan / An extract from advice received from: Link Asset Services*

DADANSODDIAD BENTHYCIADAU YN AEDDFEDU 2018/19 YMLAEN GAN PWLB / PWLB LOANS MATURITY ANALYSIS 2018/19 ONWARDS						
	PWLB Aeddefedu/ PWLB Maturity  £'000	PWLB EIP/ Annuity/ PWLB EIP/ Annuity  £'000	Benthyciadau Marchnad/ Market Loans  £'000	PWLB Amrywiol/ PWLB Variable  £'000	Cyfanswm yn Aeddfedu/ Total Maturing  £'000	%Yn Aeddfedu o'r Cyfran yn sefyll/ Maturing of Total Outstanding %
2019/20	5,000	11	0	0	5,011	4.1
2020/21	4,500	12	0	0	4,512	3.7
2021/22	0	14	0	0	14	0.0
2022/23	2,285	15	0	0	2,300	1.9
2023/24	1,854	16	0	0	1,870	1.5
2024/25	0	18	0	0	18	0.0
2025/26	0	20	0	0	20	0.0
2026/27	1,381	22	0	0	1,403	1.2
2027/28	2,165	24	0	0	2,189	1.8
2028/29	262	26	0	0	288	0.2
2029/30	1,539	21	0	0	1,560	1.3
2030/31	451	15	0	0	466	0.4
2031/32	1,941	9	0	0	1,950	1.6
2032/33	315	8	0	0	323	0.3
2033/34	637	0	0	0	637	0.5
2034/35	624	0	0	0	624	0.5
2035/36	611	0	0	0	611	0.5
2036/37	599	0	0	0	599	0.5
2037/38	587	0	0	0	587	0.5
2038/39	225	0	0	0	225	0.2
2039/40	5,000	0	0	0	5,000	4.1
2040/41	3,500	0	0	0	3,500	2.9
2042/43	1,000	0	0	0	1,000	0.8
2043/44	1,020	0	0	0	1,020	0.8
2044/45	1,010	0	0	0	1,010	0.8
2045/46	11,464	0	0	0	11,464	9.4
2050/51	2,000	0	0	0	2,000	1.6
2052/53	28,238	0	0	0	28,238	23.3
2054/55	3,000	0	0	0	3,000	2.5
2055/56	3,500	0	0	0	3,500	2.9
2056/57	5,000	0	0	0	5,000	4.1
2057/58	8,513	0	0	0	8,513	7.0
2059/60	1,763	0	0	0	1,763	1.5
2066/67	6,200	0	0	0	6,200	5.1
2068/69	15,000	0	0	0	15,000	12.4
	<b>121,184</b>	<b>236</b>	<b>0</b>	<b>0</b>	<b>121,415</b>	<b>100.0</b>
Cyfartaledd bywyd (blynyddoedd)/ Average life(years)	24.63	7.61	0.00	0.00	24.60	
Cyfartaledd graddfa (%)/ Average rate (%)	5.26	9.41	0.00	0.00	5.15	

PROFFIL AD-DALU BENTHYCIADAU ERAILL 2018/19 YMLAEN / OTHER LOANS REPAYMENT PROFILE 2018/19 ONWARDS						
	Llywodraeth Cymru / Welsh Government	Benthycaf Salix Loan 1	Benthycaf Salix Loan 2	Benthycaf Salix Loan 3	Benthycaf Salix Loan 4	Cyfanswm / Total
	£'000	£'000	£'000	£'000	£'000	£'000
2019/20	44	16	46	63	0	169
2020/21	43	16	46	63	33	201
2021/22	0	17	46	63	33	159
2022/23	0	17	46	63	33	159
2023/24	0	17	45	63	33	158
2024/25	0	8	45	64	33	150
2025/26	0	0	45	64	33	142
2026/27	0	0	0	64	33	97
2027/28	0	0	0	64	33	97
2028/29	0	0	0	64	0	64

**Minimum Revenue Provision Policy Statement 2019/20**

The Council is required to pay off an element of the accumulated Council Fund capital spend each year (the CFR) through a revenue charge (the minimum revenue provision, MRP), although it is also allowed to undertake additional voluntary payments if required (voluntary revenue provision, VRP).

The Welsh Government regulations require the full Council to approve an MRP Statement in advance of each year. A variety of options is provided to councils, so long as there is a prudent provision. The Council is recommended to approve the following MRP Statement:-

For capital expenditure incurred between 1 April 2008 and 31 March 2018, financed by supported borrowing, the MRP policy will be to charge MRP on the Equal Instalment method, Asset Life basis over 50 years. The MRP on capital expenditure funded by unsupported borrowing during this period has already been charged using the Equal Instalment method, Asset Life basis using the estimated lives of the assets, based on information available at that time. This change in policy realigns the MRP policies for assets funded by supported borrowing and assets funded by unsupported borrowing.

From 1st April 2018 for all supported and unsupported borrowing (including PFI and finance leases), the MRP policy will also be the Equal Instalment Annuity Method, the Asset Life basis. However, the estimated life periods, will be set by the S151 Officer based upon advice received from the relevant officers and will have regard to Welsh Government guidance in relation to MRP and asset lives. Where land is purchased, the asset life will be based on the asset life of the asset placed on the land, which in the majority of cases will be 50 years in line with the asset life for buildings.

MRP charges based on asset life would not be charged until the year the asset becomes operational. The S151 Officer may postpone the MRP charge until the financial year following the one in which the asset becomes operational. The estimated asset life of the asset would be determined in the year the MRP commences and would not change over the life of the asset. The estimated life periods, will be set by the S151 Officer based upon advice received from the relevant officers and will have regard to Statutory requirements and Welsh Government guidance in relation to MRP and asset life. Where land is purchased, the asset life will be based on the asset life of the asset placed on the land, which in the majority of cases will be 50 years in line with the asset life for buildings.

As some types of capital expenditure incurred by the Council are not capable of being related to an individual asset, asset lives will be assessed on a basis, which most reasonably reflects the anticipated period of benefit that arises from the expenditure. In addition, whatever type of expenditure is involved, it will be grouped together in a manner which reflects the nature of the main component of expenditure and will only be divided up in cases where there are two or more major components with substantially different useful economic lives.

The Council retains the right to make additional voluntary payments to reduce debt if deemed prudent.

The Housing Revenue Account share of the CFR is subject to a 2% MRP charge, based upon the closing CFR for the previous year, in line with the approved 30-year business plan.

Any repayments included in annual PFI or finance leases are applied as MRP and will be consistent with the asset life basis over the life of the lease or PFI scheme.

## Specified and Non-Specified Investments

The Welsh Government 'Guidance on Local Government Investments' (Effective from 1 April 2010) provides the definition of specified and non-specified investments.

Paragraph 5.1 of the 'Guidance' states that an investment is specified if all of the following apply:-

- (a) the investment is denominated in sterling and any payments or repayments in respect of the investment are payable only in sterling; and
- (b) the investment is not a long-term investment (\*); and
- (c) the making of the investment is not defined as capital expenditure by virtue of regulation 20(1)(d) of the Local Authorities (Capital Finance and Accounting) (Wales) Regulations 2003 [SI 3239 as amended]; and
- (ch) the investment is made with a body or in an investment scheme of high credit quality (\*\*); or with one of the following public-sector bodies:
  - (i) the United Kingdom Government
  - (ii) a local authority in England or Wales (as defined in section 23 of the 2003 Act) or a similar body in Scotland or Northern Ireland
  - (iii) a parish or community council.

The 'Guidance' also states that any investment not meeting the definition of paragraph 5.1 is classified as a non-specified investment.

During 2019/20 the Council does not intend to make any investments in foreign currencies, nor any with low credit quality bodies, nor any that are defined as capital expenditure by legislation (such as company shares). Non-specified investments will therefore be limited to (i) long-term investments; and (ii) deposits with the Council's own banker for transactional purposes if it fails to meet the basic credit criteria; in this instance balances will be minimised as far as is possible

The table in Appendix 6 set out the investment criteria and limits for the categories of investments intended for use during 2019/20 and therefore form the basis for the approved lending list.

Any proposed revisions or amendments during the year to the categories of specified and non-specified investments to be used and / or to the associated credit rating criteria / investment limits will be subject to prior approval by the County Council.

\* Section 2.4 of the 'Guidance' defines a long term investment as "any investment other than (a) one which is due to be repaid within 12 months of the date on which the investment was made or (b) one which the local authority may require to be repaid within that period."

\*\* For the purposes of high credit quality the 'Guidance' states that "for the purposes of paragraph 5.1(d), Welsh ministers recommend that the Strategy should define high credit quality (and where this definition refers to credit ratings, paragraph 6.1 (\*\*\*) is relevant)."

\*\*\* Paragraph 6.1 of the 'Guidance' recommends that "the Strategy should set out the authority's approach to assessing the risk of loss of investments, making clear in particular:

- (a) to what extent, if any, risk assessment is based upon credit ratings issued by one or more credit rating agencies;
- (b) where credit ratings are used, how frequently credit ratings are monitored and what action is to be taken when ratings change; and
- (c) what other sources of information on credit risk are used, additional to or instead of credit ratings."

The table in Appendix 6 of this strategy sets out what this Council defines as high credit quality and the associated investment criteria and limits and section 4.2 of this strategy sets out the Council's creditworthiness approach.

**Counterparty Criteria**

Category	Short Term Credit Rating (Fitch)	Short Term Credit Rating (Moody's)	Short Term Credit Rating (Standard & Poor's)	Long Term Credit Rating (Fitch)	Long Term Credit Rating (Moody's)	Long Term Credit Rating (Standard & Poor's)	Cash Limit	Time Limit
Bank and Building Societies (not nationalised or part nationalised)	F1+	P-1	A-1+	AAA	Aaa	AAA	£10m	5 years
	F1+	P-1	A-1+	AA	Aa2	AA	£10m	3 years
	F1+	P-1	A-1+	AA-	Aa3	AA-	£10m	364 days
	F1	P-1	A-1	A	A2	A	£7.5m	6 months
Nationalised / Part Nationalised UK Banks	n/a	n/a	n/a	n/a	n/a	n/a	£10m	364 days
UK Central Government (irrespective of credit rating)	n/a	n/a	n/a	n/a	n/a	n/a	No maximum	No maximum
UK Local Authorities**	n/a	n/a	n/a	n/a	n/a	n/a	£5m	364 days
Money Market Funds	n/a	n/a	n/a	AAA	AAA	AAA	£5m	6 months

\* as defined in the Local Authorities (Capital Finance and Accounting) (Wales) Regulations 2003

\*\* as defined in the Local Government Act 2003

**Notes and Clarifications****(1) Cash Limit**

- (i) The cash limits apply both to the individual counterparty and to the overall group to which it belongs (e.g. for the banks within the Lloyds Banking Group plc (being Bank of Scotland plc and Lloyds Bank plc), the investment limit applies to those banks individually and the banking group as a whole);
- (ii) The overall cash limit for deposits over 364 days is £15m.

**(2) Time Limit**

- (i) This up to and including the period indicated.

**(3) Foreign Countries**

- (i) Investments in foreign countries will be limited to those that hold a sovereign credit rating of (Fitch) AA- or equivalent (from the agencies referred to in section 4.3 of this strategy) sovereign credit rating (based upon the lowest common denominator), and to a maximum of £10 million per foreign country.
- (ii) Investments in countries whose lowest sovereign rating is not AA- or above will not be permitted. No country limit will apply to investments in the UK, irrespective of the sovereign credit rating.
- (iii) Subsidiaries of foreign banking groups will normally be assessed according to the country of domicile of the parent organisation. However, Santander UK plc (a subsidiary of Spain's Banco Santander) will be classed as a UK bank due to its substantial UK franchises and the arms-length nature of the parent-subsidiary relationships.
- (iv) Sovereign credit rating criteria and foreign country limits will not apply to investments in multilateral development banks (e.g. the European Investment Bank and the World Bank) or other supranational organisations (e.g. the European Union).

**4. Credit Rating Downgrade**

Should a credit rating downgrade place a counterparty below the minimum credit rating criteria for investment, the counterparty will cease to be used as soon as practicable.

If the S151 Officer wishes to continue investing with that counterparty approval will be sought from the Chair of the Audit Committee plus one other member of the Chair's choosing, who both must approve the action. This will then be reported as appropriate at the next available opportunity.

**Approved countries for investments [correct as at 8 November 2018]**

*This list is based on those countries which have sovereign ratings of AA- or higher (we show the lowest rating from Fitch, Moody's and S&P) and also, (except - at the time of writing - for Hong Kong, Norway and Luxembourg), have banks operating in sterling markets which have credit ratings of green or above in the Link Asset Services credit worthiness service.*

**Based on lowest available rating****AAA**

- Australia
- Canada
- Denmark
- Germany
- Luxembourg
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland

**AA+**

- Finland
- U.S.A.

**AA**

- Abu Dhabi (UAE)
- France
- Hong Kong
- U.K.

**AA-**

- Belgium
- Qatar

## **Treasury management scheme of delegation**

### **(i) County Council**

- budget approval;
- approval of the annual Treasury Management Strategy Statement, Annual Investment Strategy and MRP Policy, annual Treasury Management Policy Statement and amendments thereto;
- approval of amendments to the Council's adopted clauses;
- receiving and reviewing monitoring reports on treasury management policies, practices and activities; and
- acting on recommendations received from the Audit Committee and/or Executive Committee.

### **(ii) Executive Committee**

- budget consideration;
- approval of the division of responsibilities;
- approval of the selection of external service providers and agreeing terms of appointment;
- receiving and reviewing monitoring reports on treasury management policies, practices and activities and making recommendations to the County Council as appropriate; and
- acting on recommendations received from the Audit Committee.

### **(iii) Audit Committee**

- Scrutiny of Treasury Management matters as required by CIPFA's Code of Practice on Treasury Management and the Council's Treasury Management Policy. This includes:-
  - scrutinising the annual Treasury Management Strategy Statement, Annual Investment Strategy, Annual MRP Policy, Annual Treasury Management Policy and Treasury Management Practices and making recommendations to the Executive Committee and County Council as appropriate;
  - scrutinising proposals for amendments to the annual Treasury Management Strategy Statement, Annual Investment Strategy, Annual MRP Policy, Annual Treasury Management Policy and Treasury Management Practices and to the adopted clauses and making recommendations to the Executive and County Council as appropriate;
  - receiving and scrutinising any other proposals relating to the treasury management which require a decision by the Executive or County Council; and
  - receiving and scrutinising monitoring reports on treasury management policies, practices and activities and make recommendations to the Executive and County Council as appropriate.

## **The Treasury Management role of the Section 151 Officer**

### **The Section 151 (responsible) Officer's role includes:-**

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance;
- submitting regular treasury management policy reports;
- submitting budgets and budget variations;
- receiving and reviewing management information reports;
- reviewing the performance of the treasury management function;
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function;
- ensuring the adequacy of internal audit, and liaising with external audit;
- recommending the appointment of external service providers; and
- Responsibility for the execution and administration of its Treasury decisions, including decision on borrowing, investment and financing, have been delegated to the Section 151 Officer, who will act in accordance with the Council's policy statements and TMP's.



- preparation of a capital strategy to include capital expenditure, capital financing, non-financial investments and treasury management, with a long term timeframe
- ensuring that the capital strategy is prudent, sustainable, affordable and prudent in the long term and provides value for money
- ensuring that due diligence has been carried out on all treasury and non-financial investments and is in accordance with the risk appetite of the authority
- ensure that the authority has appropriate legal powers to undertake expenditure on non-financial assets and their financing
- ensuring the proportionality of all investments so that the authority does not undertake a level of investing which exposes the authority to an excessive level of risk compared to its financial resources
- ensuring that an adequate governance process is in place for the approval, monitoring and ongoing risk management of all non-financial investments and long term liabilities
- provision to members of a schedule of all non-treasury investments including material investments in subsidiaries, joint ventures, loans and financial guarantees
- ensuring that members are adequately informed and understand the risk exposures taken on by an authority
- ensuring that the authority has adequate expertise, either in house or externally provided, to carry out the above
- creation of Treasury Management Practices which specifically deal with how non treasury investments will be carried out and managed, to include the following: -
  - Risk management (TMP1 and schedules), including investment and risk management criteria for any material non-treasury investment portfolios;
  - Performance measurement and management (TMP2 and schedules), including methodology and criteria for assessing the performance and success of non-treasury investments;
  - Decision making, governance and organisation (TMP5 and schedules), including a statement of the governance requirements for decision making in relation to non-treasury investments; and arrangements to ensure that appropriate professional due diligence is carried out to support decision making;
  - Reporting and management information (TMP6 and schedules), including where and how often monitoring reports are taken;
  - Training and qualifications (TMP10 and schedules), including how the relevant knowledge and skills in relation to non-treasury investments will be arranged.

**PRUDENTIAL & TREASURY INDICATORS  
BUDGET SETTING 2019/20**

**APPENDIX 11**

**No. Indicator**

<b>Affordability</b>		<b>2017/18 out-turn</b>	<b>2018/19 estimate</b>	<b>2019/20 proposal</b>	<b>2020/21 proposal</b>	<b>2021/22 proposal</b>
<b>1,2</b>	Estimates of [or actual] ratio of financing costs to net revenue stream:					
	Council Fund	6.10%	4.95%	5.23%	5.28%	5.63%
	Housing Revenue Account (inclusive of settlement)	22.36%	16.86%	15.57%	16.08%	16.16%
	Total	7.98%	6.37%	6.51%	6.65%	7.03%
<b>Prudence</b>						
<b>3</b>	Gross debt and the Capital Financing Requirement (CFR)	✓	✓	✓	✓	✓
	<i>Is the gross external debt &lt; the CFR for the preceding year plus the estimates of any additional CFR for the current and the next two financial years?</i>			✓	✓	✓
<b>Capital Expenditure</b>		<b>£000</b>	<b>£000</b>	<b>£000</b>	<b>£000</b>	<b>£000</b>
<b>4,5</b>	Estimates of [or actual] capital expenditure					
	Council Fund	20,064	23,685	18,020	20,421	20,607
	Housing Revenue Account	9,291	10,372	13,110	18,431	19,744
	Total	29,355	34,057	31,130	38,852	40,351
<b>6,7</b>	Estimates of [or actual] Capital Financing Requirement					
	Council Fund	95,218	100,376	104,103	111,991	122,822
	Housing Revenue Account	41,648	40,815	40,998	46,479	51,999
	Total	136,866	141,191	145,101	158,469	174,821
<b>External Debt</b>		<b>£000</b>	<b>£000</b>	<b>£000</b>	<b>£000</b>	<b>£000</b>
<b>8</b>	Authorised Limit					
	: General Borrowing	166,000	174,000	175,000	189,000	205,000
	: Other long term liabilities	3,000	3,000	3,000	3,000	3,000
	: Total	169,000	177,000	178,000	192,000	208,000

9	Operational Boundary					
	: General Borrowing	161,000	161,000	170,000	184,000	200,000
	: Other long term liabilities	3,000	3,000	3,000	3,000	3,000
	: Total	164,000	164,000	173,000	187,000	203,000
10	Actual External Debt	117,029				
<b>Treasury Management</b>		<b>2016/17 out-turn</b>	<b>2017/18 estimate</b>	<b>2018/19 proposal</b>	<b>2019/20 proposal</b>	<b>2020/21 proposal</b>
11	The Local Authority has adopted the CIPFA Code of Practice for Treasury Management in the Public Services	✓	✓	✓	✓	✓
		<b>£000</b>	<b>£000</b>	<b>£000</b>	<b>£000</b>	<b>£000</b>
12	Gross and net debt	100%	100%	100%	100%	100%
	<i>The upper limit on the net debt as a proportion of gross debt</i>					
13	The upper limit on fixed rate exposures: ( net principal outstanding)	149,000	157,000	158,000	172,000	188,000
14	The upper limit on variable rate exposures: ( net principal outstanding)	20,000	20,000	20,000	20,000	20,000
15	The limit for total principal sums invested for periods longer than 364 days (any long term investments carried forward from previous years will be included in each year's limit)	15,000	15,000	15,000	15,000	15,000
			<b>2019/20 upper limit</b>		<b>2019/20 lower limit</b>	
16	The upper and lower limits for the maturity structure of fixed rate borrowing					
	• under 12 months		20%	0%		
	• 12 months and within 24 months		20%	0%		
	• 24 months and within 5 years		50%	0%		
	• 5 years and within 10 years		75%	0%		
	• 10 years and above		100%	0%		
			no change	no change		

## Information on Prudential & Treasury Management indicators

### A) Affordability

#### 1 & 2 Ratio of financing costs to net revenue stream

This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

The estimates of financing costs include current commitments and the proposals in this budget report.

### B) Prudence

#### 3 Gross Debt and the CFR

The Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2018/19 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

### C) Capital expenditure

#### 4 & 5 Estimates of Capital Expenditure

This is the forecast Capital Expenditure from 2018/19 to 2021/22, and is based on the Capital Programme for 2018/19 and the Capital Strategy for 2019/20.

#### 6 & 7 The Council's borrowing need (the Capital Financing Requirement)

Another prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying borrowing need. Any capital expenditure above, which has not immediately been paid for through a revenue or capital resource, will increase the CFR.

The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the borrowing need in line with each assets life, and so charges the economic consumption of capital assets as they are used.

The CFR includes any other long term liabilities (e.g. PFI schemes, finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility and so the Council is not required to separately borrow for these schemes. The Council currently has £nil of such schemes within the CFR.

## **CH) External Debt**

- 8. The authorised limit for external debt.** A further key prudential indicator represents a control on the maximum level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although this power has not yet been exercised.

The S151 Officer reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in the budget report.

- 9. The operational boundary.** This is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt and the ability to fund under-borrowing by other cash resources.

## Glossary

### **CAPITAL EXPENDITURE**

Capital expenditure is expenditure on the purchase of a non-current asset, which will be used in providing services beyond the current financial year, or expenditure which adds to, and not merely maintains, the value of an existing non-current asset. Examples include: the building of a new school, the purchase of IT equipment, a major refurbishment of a care home.

### **CAPITAL FINANCING**

Funds that are available to pay for capital expenditure. There are various methods of financing capital expenditure including borrowing, leasing, direct revenue financing, usable capital receipts, capital grants, capital contributions, revenue reserves and earmarked reserves.

### **CAPITAL FINANCING REQUIREMENT**

The total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying borrowing need.

### **CAPITAL PROGRAMME**

The capital schemes the Council intends to carry out over a specific period of time.

### **CAPITAL RECEIPTS**

Capital receipts represent the proceeds from the disposal of land or other non-current assets. Proportions of capital receipts can be used to finance new capital expenditure, within rules set down by the government, but they cannot be used to finance revenue expenditure.

### **CIPFA**

This is The Chartered Institute of Public Finance and Accountancy, the lead professional and regulatory body for local Authority accounting.

### **HOUSING REVENUE ACCOUNT (HRA)**

The HRA is a separate account to the Council Fund, and includes the income and expenditure arising from the provision of housing accommodation by the Council.

### **INTEREST RECEIVABLE OR PAYABLE**

The effective interest rate method is used to measure the carrying value of a financial asset or liability measured at cost less accumulated amortisation, and to allocate associated interest income or expense to the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument to equal the amount at initial recognition. The effective interest is adjusted to the actual interest payment or receipt through the Movement in Reserves Statement to ensure only actual interest is charged to Council Tax. For financial assets and liabilities carried at cost because the effective rate of interest is the same as the carrying rate of interest, the carrying value is adjusted for accrued interest.

### **MINIMUM REVENUE PROVISION (MRP)**

The minimum amount which must be charged to the revenue account each year in order to provide for the repayment of loans and other amounts borrowed by the Council.

### **NET DEBT**

The Net Debt is the Council's borrowings less cash and liquid resources.

**PUBLIC WORKS LOANS BOARD (PWLB)**

A Central Government Agency which provides loans for one year and/or more to authorities at interest rates only slightly higher than those at which the government can borrow itself.

**REVENUE EXPENDITURE FUNDED BY CAPITAL UNDER STATUTE (REFCUS)**

Expenditure which can be properly deferred (i.e. treated as capital in nature), but which does not result in, or remain matched with, a tangible asset. Examples of deferred charges are grants of a capital nature to voluntary organisations.

**REVENUE SUPPORT GRANT**

A grant paid by Central Government to authorities, contributing towards the general cost of their services.

**SUPPORTED BORROWING**

The Council borrows money to fund part of its capital programme. This borrowing is recognised by Central Government in its calculation of formula funding for the Council.

**TEMPORARY BORROWING**

Money borrowed for a period of less than one year.

**UNSUPPORTED BORROWING**

The Council can borrow additional money to the borrowing supported by Government to finance its capital expenditure as long as it is affordable and sustainable. This power is governed by the Chartered Institute of Public Finance and Accountancy's (CIPFA) Prudential Code, with which the Council fully complies.